

3Q16

Quarterly Management Report
October 13, 2016**CONTACT**

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Topics in This Report:

- Revenue Analysis
- Profit & Expense Analysis
- Financial Condition Review
- Cash Flow
- CapEx
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Operating Results Review:**Summary:***(Amounts are on consolidated basis and are in NT\$ billions unless otherwise noted)*

	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>	<u>QoQ</u>	<u>YoY</u>
EPS (NT\$ per common share)	3.73	2.80	2.91	33.4%	28.4%
(US\$ per ADR unit)	0.59	0.43	0.46	33.4%	28.4%
Net Revenue	260.41	221.81	212.51	17.4%	22.5%
Gross Profit	132.05	114.33	102.34	15.5%	29.0%
Gross Margin	50.7%	51.5%	48.2%		
Operating Expenses	(25.84)	(23.01)	(22.16)	12.3%	16.6%
Other Operating Income and Expenses	0.05	(0.00)	(1.79)		
Operating Income	106.26	91.32	78.39	16.4%	35.6%
Operating Margin	40.8%	41.2%	36.9%		
Non-Operating Items	1.99	2.09	5.01		
Net Income Attributable to Shareholders of the Parent Company	96.76	72.51	75.33	33.4%	28.4%
Net Profit Margin	37.2%	32.7%	35.4%		
Wafer Shipment (kpcs 12 inch-equiv.)	2,638	2,297	2,216	14.8%	19.0%

*Note: Diluted weighted average outstanding shares were 25,930mn units in 3Q16***Financial Highlights:****Third Quarter 2016**

- Net revenue was NT\$260.41 billion, representing a 17.4% increase from NT\$221.81 billion in 2Q16 and a 22.5% increase from NT\$212.51 billion in 3Q15.
- Gross margin was 50.7%, 0.8 percentage point lower than 2Q16 but 2.5 percentage points higher than 3Q15.
- Operating margin was 40.8%, down 0.4 percentage point from 2Q16 but up 3.9 percentage points from 3Q15.
- Non-operating items were a gain of NT\$1.99 billion, compared to a gain of NT\$2.09 billion in 2Q16 and a gain of NT\$5.01 billion in 3Q15. The year-over-year decrease mainly reflected the disposal gains of ASML shares in 3Q15.
- Net income attributable to shareholders of the parent company was NT\$96.76 billion, up 33.4% from 2Q16 and up 28.4% from 3Q15. Net profit margin was 37.2% and diluted EPS was NT\$3.73.

I. Revenue Analysis

Wafer Revenue by Application	3Q16	2Q16	3Q15
Computer	8%	8%	8%
Communication	60%	59%	59%
Consumer	11%	12%	8%
Industrial/Standard	21%	21%	25%

Wafer Revenue by Technology	3Q16	2Q16	3Q15
16/20nm	31%	23%	21%
28nm	24%	28%	27%
40/45nm	13%	15%	14%
65nm	11%	12%	11%
90nm	5%	5%	8%
0.11/0.13um	3%	2%	2%
0.15/0.18um	9%	11%	12%
0.25um and above	4%	4%	5%

Net Revenue by Geography	3Q16	2Q16	3Q15
North America	68%	61%	69%
Asia Pacific	15%	18%	12%
China	6%	10%	6%
EMEA	6%	6%	7%
Japan	5%	5%	6%

Revenue Analysis:

In the third quarter, revenue increased 17.4% quarter-over-quarter, mainly reflecting stronger-than-expected smartphone demand, partially offset by an unfavorable foreign exchange rate.

By application, Communication, Computer, Consumer, and Industrial/Standard increased 19%, 3%, 8% and 16%, respectively.

By technology, the combined 16/20nm contribution was 31% of total wafer revenue in the third quarter. Advanced technologies (28nm and below) accounted for 55% of total wafer revenue.

From a geographic perspective, revenue from customers based in North America accounted for 68% of total net revenue, while revenue from Asia Pacific, China, EMEA (Europe, Middle East, and Africa) and Japan accounted for 15%, 6%, 6%, and 5% of total net revenue, respectively.

II. Profit & Expense Analysis

II - 1. Gross Profit Analysis			
(In NT\$ billions)	3Q16	2Q16	3Q15
Cost of Revenue	128.36	107.48	110.17
Gross Profit	132.05	114.33	102.34
Gross Margin	50.7%	51.5%	48.2%

Gross Profit Analysis:

Gross margin was 50.7% in 3Q16, 0.8 percentage point lower than 2Q16, mainly due to an unfavorable foreign exchange rate and margin dilution from higher 16nm contribution, partially balanced by a higher level of capacity utilization and cost improvement.

II - 2. Operating Income Analysis

(In NT\$ billions)	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
Total Operating Expenses	(25.84)	(23.01)	(22.16)
Research & Development	(18.72)	(16.90)	(16.49)
SG&A	(7.12)	(6.11)	(5.67)
Other Operating Income and Expenses	0.05	(0.00)	(1.79)
Operating Income	106.26	91.32	78.39
Operating Margin	40.8%	41.2%	36.9%
Total Operating Expenses as % of Net Revenue	9.9%	10.3%	10.5%

Operating Income Analysis:

Total operating expenses represented 9.9% of net revenue in 3Q16 and increased NT\$2.83 billion to NT\$25.84 billion, primarily driven by a higher level of development activities for 7nm technologies.

II - 3. Non-Operating Items

(In NT\$ billions)	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
L-T Investments	0.88	0.89	0.93
SSMC	0.52	0.48	0.66
Others	0.36	0.41	0.27
Interest Expenses	(0.82)	(0.82)	(0.79)
Other Gains and Losses	1.93	2.02	4.87
Total Non-Operating Items	1.99	2.09	5.01

Non-Operating Items:

Total non-operating items were a gain of NT\$1.99 billion in 3Q16, compared to a gain of NT\$2.09 billion in 2Q16.

III. Financial Condition Review

III - 1. Liquidity Analysis (Balance Sheet Items)

(In NT\$ billions)	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
Cash & Marketable Securities	516.95	667.86	524.88
Accounts Receivable	129.29	111.72	97.12
Inventories	53.88	60.71	65.07
Other Current Assets	9.47	12.23	6.59
Total Current Assets	709.59	852.52	693.66
Short-term Loans	37.65	38.74	33.56
Accounts Payable	84.77	71.25	53.52
Current Portion of Bonds Payable and Bank Loans	38.11	22.01	23.52
Dividends Payable	0.00	155.70	0.00
Accrued Liabilities and Others	97.03	111.04	91.09
Total Current Liabilities	257.56	398.74	201.69
Current Ratio (x)	2.8	2.1	3.4
Net Working Capital	452.03	453.78	491.97

Liquidity Analysis:

At the end of 3Q16, cash and marketable securities decreased by NT\$150.91 billion to NT\$516.95 billion, primarily due to the payment of NT\$155.70 billion cash dividends, while marketable securities increased by NT\$7.48 billion.

Total current liabilities decreased by NT\$141.18 billion, largely attributable to the cash dividend payment during the quarter.

Net working capital was NT\$452.03 billion and current ratio was 2.8x.

III - 2. Receivable/Inventory Days

(In Number of Days)

	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
Days of Receivable	42	43	42
Days of Inventory	44	54	59

Receivable and Inventory Days:

Days of receivable decreased 1 day to 42 days in 3Q16.

Days of inventory decreased 10 days to 44 days in 3Q16, mainly due to reduction in work-in-process as a result of stronger wafer shipments during the quarter and improving cycle time.

III - 3. Debt Service

(In NT\$ billions)

	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
Cash & Marketable Securities	516.95	667.86	524.88
Interest-Bearing Debts	(227.92)	(242.05)	(249.09)
Net Cash Reserves	289.03	425.81	275.79

Debt Service:

Net cash reserves decreased NT\$136.78 billion to NT\$289.03 billion in 3Q16, reflecting the decrease of NT\$150.91 billion in cash & marketable securities, partially balanced by the repayment of NT\$12.00 billion in corporate bonds.

IV. Cash Flow

IV - 1. Quarterly Cash Flow Analysis

(In NT\$ billions)

	<u>3Q16</u>	<u>2Q16</u>	<u>3Q15</u>
Income before Income Tax	108.25	93.41	83.39
Depreciation & Amortization	56.27	55.28	56.15
Other Operating Sources/(Uses)	(38.11)	(42.01)	(21.40)
Total Operating Sources/(Uses)	126.41	106.68	118.14
Capital Expenditures	(103.78)	(73.59)	(70.30)
Marketable Financial Instruments	(8.91)	(22.07)	11.98
Other Investing Sources/(Uses)	5.80	0.95	3.53
Net Investing Sources/(Uses)	(106.89)	(94.71)	(54.79)
Increase (Decrease) in Short-term Loans	0.00	3.96	27.70
Cash Dividends	(155.58)	0.00	(116.68)
Other Financing Sources/(Uses)	(13.61)	(12.06)	(1.50)
Net Financing Sources/(Uses)	(169.19)	(8.10)	(90.48)
Exchange Rate Changes and Other	(8.72)	0.51	13.96
Net Cash Position Changes	(158.39)	4.38	(13.17)
Ending Cash Balance	463.97	622.36	515.73

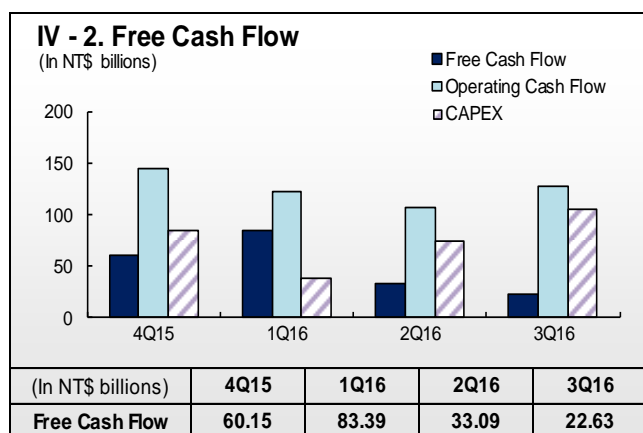
Summary of Cash Flow:

During the third quarter, cash generated from operating activities totaled NT\$126.41 billion, including (1) NT\$56.27 billion from depreciation & amortization expenses and (2) NT\$38.11 billion for other operating uses, which mainly reflected an increase of NT\$17.56 billion in accounts receivable and the payment of NT\$15.22 billion for 2016 provisional income tax.

Net cash used in investing activities was NT\$106.89 billion in 3Q16, primarily including capital expenditures of NT\$103.78 billion.

Net cash used in financing activities was NT\$169.19 billion, largely due to the payment of cash dividends.

As a result, net cash position decreased NT\$158.39 billion to NT\$463.97 billion at the end of 3Q16.



Operating and Free Cash Flow:

Free cash flow was NT\$22.63 billion in 3Q16, a decrease of NT\$10.46 billion, as the increase in capital expenditures outpaced the increase in operating cash flow.

V. CapEx

V. Capital Expenditures
(in US\$ billions)

	<u>3Q16</u>	<u>2Q16</u>	<u>1Q16</u>	<u>YTD</u>
Capital Expenditures	3.25	2.26	1.15	6.66

Capital Expenditures:

Capital expenditures for TSMC on a consolidated basis totaled US\$3.25 billion in 3Q16. The Company now expects its full year capital budget to be slightly above US\$9.5 billion.

VI. Recap of Recent Important Events & Announcements

- Renesas Electronics and TSMC Announce 28nm MCU Collaboration for Next-Generation Green and Autonomous Vehicles (2016/09/01)
- TSMC's Board approved the acquisition from VisEra Holding Company of 86.9% shareholding in VisEra Technologies Company Ltd. and 6.9% shareholding in Xintec Inc. to simplify investment structure (2016/08/02)